FMA Focus
BITCOIN & CO

Crypto assets

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Bitcoin & Co from the perspective of investor protection

Currently there is a boom on the Internet for offers for digital instruments of exchange and payment, for which terms like "virtual currency", "cryptocurrency", "coin" or "token" are used. There is currently only a legal definition for the term "virtual currency" (https://www.fma.gv.at/en/glossary/virtual-currencies/)(see Article 3 (18) of Directive (EU) 2018/843). Irrespective of the legal definition the term "virtual currency" is currently being viewed critically. Recently the term "crypto assets" (https://www.fma.gv.at/en/glossary/crypto-assets/) has been used as an umbrella term for the terms mentioned, including in this article.

Crypto assets should not be allowed to be confused with traditional currencies issued by central banks, since, as a rule, they are generated, managed and transferred exclusively using a mathematical computer-based procedure. They are not backed by a central bank, an authority or a financially powerful institution, that is able to guarantee that a claim to a benefit is met. Crypto assets are neither legal tender payment instruments, nor do they constitute tradable foreign currencies. It is not compulsory to accept them, and to date they have only rarely been accepted as a means of payment.

Crypto assets are neither subject to regulation nor to supervision by the FMA under the current legislation. Business models that make use of crypto assets, may however require a licence in accordance with legal regulations that have been entrusted to the FMA for enforcement.

Purchasing crypto assets is a highly speculative and very risky business. In this FMA Focus, we explain those risks that are typically associated with the use of crypto assets, using Bitcoin as an example.

Strong exchange rate fluctuations

Conventional currencies are mainly issued by a government-run central bank, the objective of which is generally to ensure monetary stability and pricing stability. Such organisations therefore intervene in the event of exchange rate fluctuations between too large, in order to ensure that the most stable possible exchange conditions are maintained for commodities and currencies.

This is not the case for crypto assets: their value remains unsecured and is determined purely by supply and demand. Consequently crypto assets are subject to strong fluctuations. Such drastic exchange rate fluctuations make crypto assets speculative instruments, while harbouring the risk of loss of value and also undermining their usability as means of payment.

Recently the value of Bitcoin, for example, has increased very strongly. Strong demand, driven by the expectation that the value will increase further, may however lead to the emergence of a speculation bubble. As soon as no-one is no longer willing to pay a speculatively high price the bubble bursts and the exchange rate collapses completely. Those who invested last sustain the largest losses - in the worst case scenario sustaining a total loss.

Trading platforms are not regulated and are not subject to supervision

Trading platforms for crypto assets are currently not subject to any form of supervision by an authority. The consumer protection regulations that apply under banking law therefore do not apply to virtual currencies, and therefore there is also no protection provided by a deposit guarantee scheme.

A trading platform may be closed down at any time, and some platforms have already ceased to trade. When a trading platform is shut down, e.g. by prohibiting the buying and selling and trading of crypto assets, no form of legal or investor protection exists. You could lose your entire invested assets. In such a case, there is no central operator that is liable for the arising damages.

IT Risk

There are also no legal stipulated minimum IT standards or security regulations in relation to the respective software used. This creates various risks, such as losses arising from hacker attacks, software errors, or data loss.

Digital wallets (known as "wallets" https://www.fma.gv.at/en/glossary/wallet/) are stored on computers, laptops and smartphones and are therefore also vulnerable to attack by hackers. Data is not stored centrally, and in the event that you lose the key for your own digital wallet, there is no way of being able to access it. There are also no contact persons available to handle complaints or enquiries or to provide assistance.

No special legal protection when using crypto assets

Unauthorised or incorrect transactions cannot be reversed, and there is also no responsible contact person for a refund. Acceptance as a form of payment is not guaranteed, and therefore remains at the full discretion of the respective contractual partner. There is no legal provision that obliges someone to accept Bitcoin as a means of payment or that authorised someone to convert Bitcoins into real currencies. There is no guarantee of the permanent existence as a digital currency as a means for exchange and payment.

The systems are very susceptible to criminal abuse due to the anonymity of users

Since transactions are barely traceable and both the recipient and sender remain anonymous, the aforementioned transactions may easily be exploited for the financing of criminal acts; such as money laundering, drug dealing or child pornography. As crypto assets are neither regulated nor subject to supervision and legal prosecution and enforcement is very difficult over the Internet, such types of system are very vulnerable to being misused for criminal purposes.

Further information on this topic can be found in the FinTech Navigator:
https://www.fma.gv.at/en/cross-sectoral-topics/fintech-navigator/

Developments in European Law:

The European Banking Authority (EBA) made consumers and supervisory authorities aware of the risks relating to the purchasing, holding or trading in virtual currencies in December 2013 and in July 2014 https://www.eba.europa.eu/-/eba-warns-consumers-on-virtual-currencies; http://www.eba.europa.eu/-/eba-proposes-potential-regulatory-regime-for-virtual-currencies-but-also-advises-that-financial-institutions-should-not-buy-hold-or-sell-them-whilst-n
In November 2017 the European Securities and Markets Authority (ESMA) issued a warning in relation to the high risks attached to Initial Coin Offerings (ICOs) https://www.esma.europa.eu/press-news/esma-news/esma-highlights-ico-risks-investors-and-firms

In February 2018 the EBA, ESMA and the European Insurance and Occupational Pensions Authority (EIOPA) issued a joint warning (as "the three European Supervisory Authorities", or "ESAs"). In this warning consumers are warned about the high risks that are associated with the purchase and/or holding of virtual currencies, (VCs) https://www.esma.europa.eu/press-news/esma-news/esas-warn-consumers-risks-in-buying-virtual-currencies; https://eiopa.europa.eu/Publications/Press%20Releases/ESAs%20warn%20consumers%20of%20risks%20in%20buying%20virtual%20currencies.pdf

On 19.06.2018 the Directive amending the 4th Anti-Money Laundering Directive (the "5th AMLD")was published in the Official Journal of the European Union. The 5th Anti Money Laundering Directive contains definitions for the terms "virtual currencies", "providers engaged in exchange services between virtual currencies and fiat currencies" and "custodian wallet providers". The scope of application of AML/CFT rules is extended to include so-called "wallet providers" and platforms for exchanging virtual currencies, and such providers are required as (new) obliged entities to meet the due diligence obligations for the prevention of money laundering and terrorist financing. Furthermore the mandatory registration of such service providers is stipulated.